

STATE OF CALIFORNIA

STATE BOARD OF EQUALIZATION

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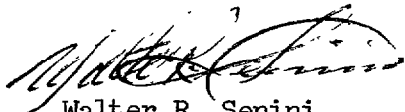
TO COUNTY ASSESSORS:

VALUATION OF NEWLY CONSTRUCTED PROPERTY

Here is another in the series of letters concerning the implementation of Article XIII A of the Constitution. The enclosed questions and answers illustrate the proper valuation procedures to be followed when valuing newly constructed property.

Please refer any inquiries or additional questions to John McCoy of our Assessment Standards Division, (916) 445-4982.

Sincerely,


Walter R. Senini
Assistant Executive Secretary
Property Tax Department

WRS:sk
Enclosures

A. QUESTIONS & ANSWERS PERTAINING TO
NEWLY CONSTRUCTED PROPERTY

1. QUESTION: Does Rule No. 463 apply to residential, commercial, and industrial property?

ANSWER: Yes. Because the constitutional amendment does not specify any single property type, Rule No. 463 is applicable to all types of real property.

2. QUESTION: How should newly constructed property be valued?

ANSWER: The aim of the appraisal is market value, and the use of any of the three approaches to value is appropriate. When more than one approach is available, the value indicators must be correlated.

3. QUESTION: How could the comparative sales approach be used to value an addition?

ANSWER: The value of the addition can be measured by comparing recent sales prices of similar properties with and without the newly constructed addition. If land values of both properties are equal, the difference in selling prices should be attributable to the addition.

4. QUESTION: If a property's base value has been determined via the income approach, how can new construction be valued using the same approach?

ANSWER: By using an improvement residual technique. Upon completion of the new construction, the appraiser should estimate the economic rent for the property and deduct the income attributable to the land to determine the current income attributable to the total improvements. The same procedure would be followed to determine pre-new construction improvement income. The difference between these figures will be the income attributable to the new construction which can be capitalized into a value indicator by applying a capitalization rate appropriate for the valuation date.

5. QUESTION: Won't the cost approach be the primary method of valuing new construction?

ANSWER: In many instances the scarcity of comparable sales data and the difficulty of making income projections will limit the appraiser to using the replacement cost approach. The simplicity of the cost approach may make it desirable when

time and resources are limited, but the appraiser should not fall into the trap of assuming cost invariably equals current value.

In establishing the market value of the newly constructed property, the appraiser should use typical costs as indicated by similar current construction to check the actual contract costs for the subject. In many instances the actual contract costs may include costs of partial removal of old improvements as well as costs of new construction and adjustments must be made.

6. QUESTION: Is the term "newly constructed property" applicable only to structural improvements?

ANSWER: No. Improvements to land are also "newly constructed property."

7. QUESTION: What are examples of improvements classified as land that would qualify as newly constructed under Rule No. 463?

ANSWER: Common examples of improvements classified as land that could be newly constructed are listed in Board Rule No. 124 and include such things as mines and quarries; oil, gas and water wells; land leveling and contouring; earthen dams, levees, irrigation ditches and roads; curbs, gutters, and underground storm drains and sewer lines.

8. QUESTION: When raw land is subdivided into subdivision lots, is the land valued as newly constructed?

ANSWER: Merely subdividing raw land into subunits does not qualify the land as newly constructed. However, lot improvements such as excavation, leveling, contouring and/or draining would qualify as new construction. The value of improvements located on deeded streets or rights-of-way cannot be attributed to the lots until such time as the lots are sold.

9. QUESTION: How is land's base year value changed by improvements classified as land?

ANSWER: Until the land changes ownership, the factored base year land value must be maintained. However, if the land is newly constructed by leveling, contouring or reinforcing with retaining walls, etc., the value of the improvements

classified as land are added to the factored raw land value. In subsequent years this combined value is subject to appropriate Consumer Price Index (CPI) adjustments.

10. QUESTION: How do you value new construction classified as land?

ANSWER: Like any improvement, newly constructed land improvements are valued at market value. Typically, sales of similar property, with and without comparable improvements, will provide the most accurate indicators of the improvement's value. The cost approach is an alternative when comparable sales are not available. However, when using this method it must be kept in mind that cost does not necessarily equal the new construction's value. The income approach is also applicable on specific properties and must be used on restricted open-space lands.

11. QUESTION: What type of structural improvements are considered newly constructed?

ANSWER: Board Rule 463 specifies newly constructed improvements are any addition of improvements or alteration of existing improvements if they increase usable square footage or if they result in conversion to another use or materially increase usefulness or extend the economic life of the structure. The foremost example of a new structural improvement is the newly constructed building on a previously vacant lot. Other examples are room additions, new swimming pools, additional stories on existing structures, new wings on hospitals, garage conversions, residences remodeled into commercial offices if structural changes are made, e.g., new plumbing, partitions moved, extra electrical service, and old buildings in redevelopment areas that have been rebuilt to house modern restaurants and commercial businesses while still maintaining the dated exterior appearance.

Routine and normal maintenance such as painting, reroofing, and plumbing repair is not new construction and is not grounds for reappraisal; neither is the replacement of short-lived items such as furnaces, hot water tanks, or fixtures and appliances. Such replacements do not change the use or the life expectancy of the structure.

12. QUESTION: How is a garage conversion valued?

ANSWER: Typically, sales of similar properties with and without garage conversions will provide the best indicator of

value. The advantage to the market approach is that the true value of the conversion is measured rather than the cost. The value of the garage is not removed from the factored base year value of the property because the structure still exists. In the absence of market comparables, the historical (actual) cost of the conversion should approximate its value.

On the lien date immediately following the completion of the conversion, the conversion value will not be factored. However, in subsequent years the total value of all components will be trended at the allowable CPI factor. This procedure also applies to finishing unfinished building areas such as attics, porches, and basements.

13. QUESTION: If the use of a residence in a commercial zone changes to professional offices, does it qualify for revaluation as newly constructed under Rule No. 463?

ANSWER: No. Merely changing a structure's use is not grounds for reappraisal.

14. QUESTION: Are structural changes such as the widening of doorways and the installation of wheel chair ramps considered new construction under Rule No. 463?

ANSWER: Each case should be considered on its merit. The key is probably found in the statement in Rule 463 "...any alteration that materially increases the usefulness of the structure...." While such an alteration might be useful to a certain group of people, the definition of value implies value to persons generally.

15. QUESTION: If the owner of a commercial office building renovates to suit a new tenant by moving partitions, painting, recarpeting and relocating electrical and telephone, should the property be revalued as newly constructed alteration?

ANSWER: The renovation as described would not meet the requirements for new construction because the usefulness of the structure has not changed. True the alterations may attract a particularly desired tenant, but there is every likelihood that normal maintenance would attract another equally desirable tenant at a comparable rent with no outlay for expensive remodeling.

16. QUESTION: If an oil company renovates a service station by installing a new underground tank for unleaded gasoline, cosmetically refacing the structure and canopy and installing new dispensers, does the renovation qualify as newly constructed?

ANSWER: There are three components to the question. First, the value of the new tank must be picked up. Second, a cosmetic refacing, unless it raises the quality class and extends the station's economic life must be judged on whether it materially increases the usefulness of the structure. Third, the new dispensers must be valued but the value of the removed dispenser must be deducted.

17. QUESTION: What is the recommended approach to appraise the above property?

ANSWER: Unfortunately market and income data are difficult to obtain when company stations are concerned. Therefore, the cost approach may be the only indicator available. However, care must be exercised not to automatically equate cost with value. In competitive businesses this type of investment may be required just to hold one's share of the market or maintain the property's existing value. If, however, the improvement extends the economic life or increases the income potential, it does have value.

18. QUESTION: If remodeling a kitchen or bath makes a home more desirable, why isn't the remodeling picked up as newly constructed?

ANSWER: The key is in "increased usefulness" and "extended life." One must consider the fact that the remodeled kitchen and bath fall under the heading of curable functional obsolescence while the anticipated life of the structure is based on a composite of incurable physical deterioration and functional obsolescence.

19. QUESTION: How do you value a new building that is under construction during a period encompassing several lien dates?

ANSWER: For each successive lien date following the commencement of construction, the value of the improvements are estimated by determining the value as if construction were complete and then adjusting the value to a percent of completion. CPI factoring on the improvement value should not begin until the lien date following the lien date upon which the complete improvement value is enrolled.